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Honorable City Council  
Detroit, Michigan

Good morning.

I am pleased to provide you with our analysis of the Mayor's proposed budget.

My address to Your Honorable Body today focuses on the City's deficits, which are being masked by the issuance of bonds to cover the City's deficient cash flows.

I plan to show you that, despite the limited number of layoffs announced by the Mayor, our City government should be in crisis mode – that the City's financial situation is bad and will continue to worsen over the next decade due to the tailspin in which we find ourselves, namely, a decreasing population; higher tax rates than other communities in the area; declining local, state, and federal revenues; and accelerating costs.

As you know, last year, in order to present a balanced budget, the mayor proposed a **one-time** financing of the contribution (insurance premium) to the risk management fund by issuing long-term bonds. This year, the mayor is proposing to finance the risk management premium by issuing long-term bonds **once more**. However, this time, he did not label it as a one-time measure.

Last year, we were faced with reduced revenues along with increased costs. So we borrowed money to give us **time** to develop a **plan**. This year, we are again faced with reduced revenues and cost increases, and we are still without a **plan**. So we are borrowing money again to give us **more time** to develop a **plan**. Next year, the challenges will not be gone. We will be faced with more revenue reductions and more cost increases.

The mayor proudly reports that he has presented a balanced budget without any cuts in City services and without significant layoffs, as other cities have done – as if other cities across the country are unwise to cut their losses; as if the other cities across the country are not as innovative as we are; as if we know something that other major cities do not know; as if delaying the inevitable cost cuts by borrowing long-term to finance the City's short-term expenses is something to be proud of.

The Mayor contends that he has solved the City's financial shortfalls in each of the last three years. Here's how:

He borrowed \$70 million to cover the current-year risk management obligations (despite receiving a one-time \$46 million contribution from the casinos); and he plans to borrow \$202 million to cover last year's \$61 million deficit (despite a \$54 million casino infusion) and part of next year's expenses. Why? Because we refuse to do what has to be done, i.e., dramatically reduce the cost of City government.

However, the credit well will soon dry up, and we will be forced to make the hard decisions that nobody likes to make. As the following chart and table illustrate, the City is facing challenging times – not because revenues have fallen drastically, but rather, because of continued rising costs.





### COMPARISON OF PERSONNEL COSTS AND MAJOR REVENUES FOR YEARS ENDED 1995 THROUGH 2005



	In Millions		
	2004-2005 Mayor's Budget	1994-1995 Budget	Increase (Decrease)
<u>Major Revenues:</u>			
Municipal Income Tax Revenue	\$ 311.0	\$ 296.3	\$ 14.7
Property Tax Revenue	185.8	161.7	24.1
State Revenue Sharing	287.7	280.1	7.6
Utility Users Tax	55.0	52.5	2.5
Wagering Tax Revenue	115.6	—	115.6
Total Major Revenues	\$ 955.1	\$ 790.6	\$ 164.5
<u>Personnel Costs:</u>			
General City Salaries	\$ 597.2	\$ 431.5	\$ 165.7
General City Benefits	459.2	254.6	204.6
Total Personnel Costs	\$ 1,056.4	\$ 686.1	\$ 370.3
Increase (Decrease) in Surplus	\$ (101.3)	\$ 104.5	\$ (205.8)

By not making the hard decisions today, we are digging ourselves a hole that we will be unable to climb out of in the foreseeable future because, as we look ahead, the City's financial challenges will become increasingly more difficult to overcome.



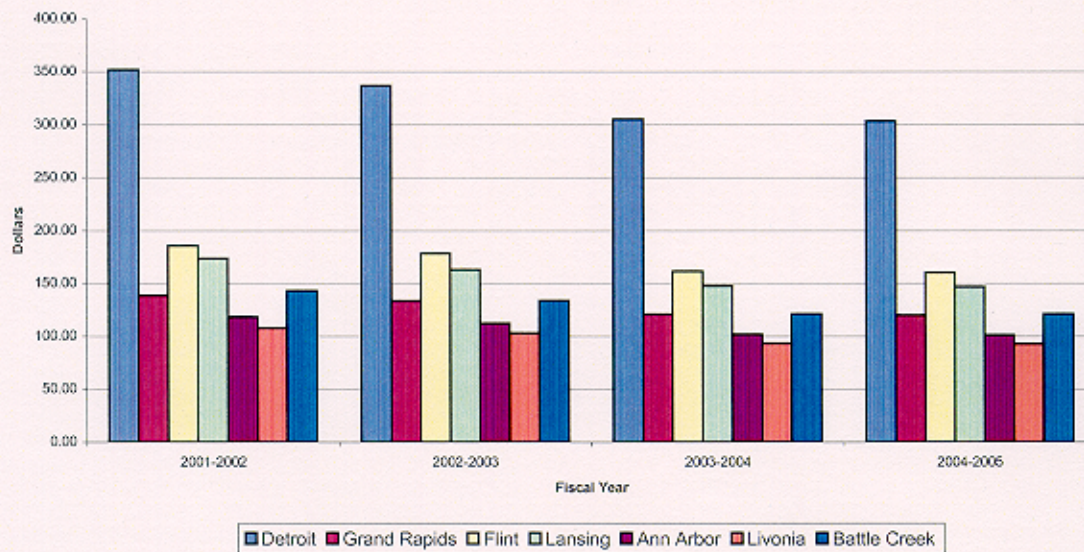


The Mayor's current strategy defies *the first rule of holes*, which is: "When you're in one, quit digging."

City officials need to realize that income tax revenues will continue to decline as tax rates fall and the City continues to lose population.

City officials need to realize that State revenue sharing will continue to fall as the State's obligations continue to exceed its revenue potential, and while out-state legislators appeal for a more equitable share of the state revenue sharing pie.

Revenue Sharing Per Capita



State Revenue Sharing Per Capita

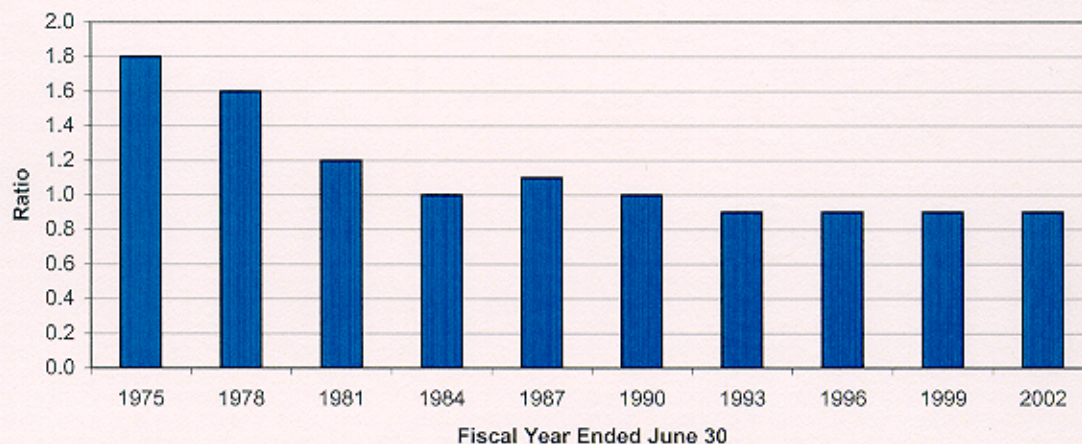
City.	2001-2002		2002-2003		2003-2004		2004-2005	
	Per Capita Revenue Sharing	Percent of Total State Revenue Sharing	Per Capita Revenue Sharing	Percent of Total State Revenue Sharing	Per Capita Revenue Sharing	Percent of Total State Revenue Sharing	Per Capita Revenue Sharing	Percent of Total State Revenue Sharing
Detroit	\$351.76	22.01%	\$336.84	22.03%	\$305.16	22.03%	\$303.13	25.34%
Grand Rapids	138.67	1.80	133.44	1.81	120.89	1.81	120.08	2.09
Flint	185.73	1.53	178.34	1.53	161.56	1.52	160.49	1.76
Lansing	173.52	2.31	163.02	1.29	147.69	1.28	146.71	1.48
Ann Arbor	118.58	0.89	112.38	0.88	101.81	0.88	101.13	1.01
Livonia	107.90	0.71	103.12	0.72	93.42	0.71	92.80	0.82





City officials also need to realize that pension costs will rise to unimagined levels – unimagined because no forecasts have been developed to alert City officials of the long-term effects of yesterday's and today's decisions.

### COMBINED PENSION SYSTEMS RATIO OF ACTIVE MEMBERS TO RETIRED MEMBERS



In addition, City officials need to realize that the cost of health care benefits will continue to escalate as a result of the continually increasing number of persons the City is obligated to cover; and also the increasing cost per person due to double-digit increases in the cost of health care premiums.

In the nineties, the irrational exuberance that fueled the stock market, which fueled the economy, which, in turn, fueled the stock market, which in turn fueled the economy in what appeared to be a never-ending cycle, has ended. We have left the aberrant nineties and we have entered a world of economic normality that gives us no rationale for delaying reductions in the cost of government.

If we are waiting to see the light at the end of the tunnel before we get our house in order, we will wait forever because there is no tunnel. We are just in the dark.

The helmsman has no map and no compass; and the ship has hit the sand. There is no **plan** for addressing the City's financial and operational needs.

As most of you may recall, I have expressed the need for a strategic **plan** in each of the last several years. This recommendation has fallen on deaf ears each year.

The City needs to develop a strategic **plan** – a **plan** that not only describes the vision of the administration, and its goals and objectives, but also the manner in which it will achieve its goals and objectives, financially, administratively, and operationally.





There is no strategically viable **plan**. Borrowing is a temporary tactic. As you recall, the tactic last year was to borrow money **one time**, to give the City **time** to develop a long-term strategy. Evidently, one year was not enough **time**. So, it's back to the well again this year, until we can find **time** to develop a long-term strategy.

Interestingly, the \$40 million per year savings potential, which we identified in the 2001 Department of Transportation audit, has not been pursued. As you know, and as documented in our 2001 audit report, the Detroit Department of Transportation has been and continues to be the most poorly managed transportation agency in the nation – in terms of service, costs, operations, and administration; and it has continually been run by individuals who have not been affiliated with best practices in the urban transportation industry.

Also, the \$3 million per year savings we identified in the 2001 telecommunications audit has not been pursued, despite the initiatives that have taken place in Oakland County, and in major cities around the nation.

In addition, the \$5 million per year savings we identified in the 2000 Workers' Compensation audit has not been pursued.

Further, the \$2 million savings from the maintenance contract consolidation plan we recommended in 1999 has never been considered.

Furthermore, the PLD modernization plan has never been pursued.

Those millions of dollars we have failed to pursue would be quite helpful right here and right now.

All of these opportunities should be included in a comprehensive plan to help ward off the impending crises, which are primarily due to personnel costs, such as pension costs. The unfunded liability of the Police and Fire Pension Fund transmuted from a \$112 million surplus to a \$516 million deficiency in one year, while the General Retirement System's unfunded liability has grown to a \$733 million deficiency, for a total unfunded liability of over \$1.2 billion.

The City has made no strategic preparations to address the financial challenges that will confront us during the next ten years. If we continue to think in terms of today, tomorrow, next month, and next year, and fail to consider the long-term detrimental impact of today's ill-advised decisions on the City's financial viability in future years, it will soon be too late to recover without the State's intervention because the City's future leaders will be unable to undo the damage we are inflicting today.

Our myopic management strategy is destined to have grave effects on the City's ability to provide basic services to its residents. Myopia manifests itself in many ways that affect the City's coffers:

- It appears when City officials decide to award a contract to a business because it is a Detroit-based business, despite the fact that its bid exceeds the lowest bid by over a half-million dollars.
- It shows up when the City elects to purchase from brokers who have an office in the City, rather than to request or accept lower bids directly from manufacturers or suppliers that are located outside of the City.





- It materializes whenever temporary convenience is exchanged for hard choices.
- It emerges every time the City compromises costs in order to favor some individuals.
- It arises when the City elects to raise bus fares for the disabled, rather than reengineer the Department of Transportation's operations, which we have shown to cost the City in excess of \$40 million more annually than the benchmarked cities for comparable operations.
- It is exposed when there are no plans to exploit reengineering opportunities that promise savings of tens of millions of dollars each year.
- It is evident when no long-range plans are developed.
- It is revealed when City officials ignore significant cost-saving measures, but continue to look for more taxes and fees to balance the budget.

City officials continue to overlook the insidious effect of overtaxing citizens due to the City's inefficient operations. Although the turnout at the polls has not reflected our citizens' collective displeasure with City government, the young, the educated, and the professionals are voting with their feet. SEMCOG estimates that the City's population has decreased by 34,000 in the past four years. The City is hemorrhaging its most vital asset – its people ... its future.

In closing, I present the following recommendations for your consideration:

- Develop a strategic **plan** based on a best-case scenario and a worst-case scenario.
- Prepare an alternative budget that provides for actions the City will take if revenue shortfalls and/or cost-increases exceed expectations. Borrowing more money must be an avenue of last resort.
- Utilize the "Balanced Scorecard" performance measurement system to encourage accountability.
- Implement Program Budgeting and Activity Based Costing to enable the City to budget and track the cost of the City's service efforts, help gauge efficiency, and improve accountability.
- Begin implementation of the revenue generating and cost reduction recommendations we have provided.
- Prioritize reengineering efforts based on return-on-investment (ROI). Then use the savings thereby generated to reengineer additional processes.
- Appoint a reengineering czar.
- Appoint a risk management officer.





If these recommendations look familiar, they should. I have made all of them in previous messages to you, with accompanying reasons why they should be adopted. Sound financial and management principals are not dependent on whether times are good or bad. However, the immediate implementation of these recommendations is more critical than ever, considering the City's current financial challenges, and the fact that the benefits cannot be realized overnight.

Next year, I will present my tenth, and last, budget message to Your Honorable Body. I will, then, begin preparation for my retirement as I will not be a candidate for any office within the City – appointed or elected.

After my departure, I will look with continued interest on our City to see when, if ever, City officials finally understand what it takes to become a world-class city – when long-range **planning** becomes the watchword; where half-million dollar variances between bids become significant; where City services need not be performed by City workers or City-based businesses when they are uncompetitive; where attrition from reengineering is preferred to crisis-dictated layoffs; and where archaic processes are replaced by best practices.

Then, and only then, will we see the light – and then, and only then, will this City have an opportunity to realize its potential.

Joseph L. Harris  
Auditor General